



KPMG ANALYSIS

Consumer Electronics Sales Defy Bad Economic News

June 20, 2008

By Dave Pelland, Managing Editor, Digital Insider

While U.S. sales growth is slowing for some products such as digital cameras and camcorders, flat-panel and other digital television displays are powering overall sales gains in consumer electronics.

The economy is creating challenges for CE manufacturers and retailers, but consumers' desire for larger TV sets, mobile phones and laptops means they are still optimistic about 2008.

"We've slowed down from 8 or 9 percent growth last year to 6 percent [in the Americas] this year -- that's still a tremendous growth rate relative to other industries," said Shawn DuBravac, a Consumer Electronics Association economist, at an industry update held in conjunction with CEA's Digital Downtown conference in New York.

"There are plenty of industries that would die for 6 percent annual growth," DuBravac said.

Over the past seven years, the consumer electronics industry has had an annual compound growth rate of 9.8 percent. CEA estimates global sales will reach \$171.5 billion at the wholesale level this year, compared with \$161.6 billion last year (and \$149.1 billion in 2006).

Much of that growth will come from television sales. According to CEA, about 29 million digital TV sets are expected to be sold in the United States this year, with about 75 percent of that coming from flat-panel displays.

While picture and sound quality remain important factors as consumers evaluate high-definition TV sets, a display's appearance is playing a larger role in buying decisions.

For instance, most consumers are buying HD displays with 1080p resolution, and Blu-ray disc players have won the format battle against high-definition DVDs.

TVs Are Looking Good

Because these standards have been settled, TV manufacturers are unveiling design elements such as flat-panel displays as thin as 1.5 inches, and shrinking the size of the bezel framing the screen glass.

"We're seeing style and design becoming more important in the purchasing decision," said Leon Temiz, president and CEO of retailer Electronics Expo. "People are looking

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at how a flat-panel is going to fit in their decor. Most of the brands make sets with good pictures that people are happy with, so design is becoming more important."

TV makers and retailers are also optimistic because households average about three television sets each, but most homes have purchased only one high-definition set. The industry expects sales to remain robust as customers gradually replace their second and third television sets with high-definition models.

On the retail side, the slowing U.S. economy has resulted in falling prices and margins for hardware and has increased the importance of discounters and non-traditional CE sales outlets.

Steve Koenig, director of industry analysis for the CEA, said the leading CE retailers are shifting as more companies offer electronics products. For example, while retail giants such as Best Buy and Wal-Mart Stores top the list of the largest CE retailers, Home Depot, Toys R Us and Gamestop have moved up. PC manufacturer HP debuted on the top 100 last year at number 25, as did outdoors gear seller Cabela's (at 97).

"Consumers want to buy CE [products] where they're already shopping," Koenig said.

And more CE manufacturers are emulating Apple, either by opening their own branded outlets (as with Sony and Bose) or using retail sales to supplement their direct-to-consumer channels (in the case of Dell).

Koenig said a retail presence can help CE manufacturers enhance consumers' affiliation with their brands through in-store support services or training classes.

"We're seeing a lot of experimentation in the quest for revenue," he added.

Because discounters and warehouse clubs usually don't provide as much sales support as specialty merchants, electronics retailers are helping consumers set up and operate CE products through installation and support services.

"Retailers are increasingly trying to bring their in-store expertise directly to consumers' homes," Koenig said. "Now Best Buy and Circuit City are making house calls."

Tim Herbert, senior director of market research for CEA, said slower growth in the Americas is expected to be offset by stronger gains in emerging markets such as China and India, where the developing middle class is driving sales of mobile handsets and notebook PCs. In Asia, CEA expects 11.1 percent sales growth in 2008, while Europe and the Middle East regions are expected to reach 8.1 percent growth.

Shifting Consumer Spending

CE firms are also optimistic about shifting consumer spending patterns. Jim Bottoms, co-managing director of consulting firm Understanding & Solutions, said consumer electronics sales haven't declined in past recessions, and although consumers spend less outside the home during downturns, many spend more on home entertainment.

"The content community benefits as consumers spend more time and money on entertainment in the home," Bottoms said. "We see sales increase for content

packaged for the home."

Retailers are also using partnerships to sell services or content that complement their CE device offerings, such as photo printing (either online or with in-store kiosks) or bundling subscriptions to online music stores with MP3 players.

"When we look at the long term, the CE industry tends to outperform the overall economy," said Sean Wargo, president of research firm MarketSage. "We're seeing from a lot of companies that do long-range forecasting say that [in 2008 and 2009], while growth may be less than in prior years, we still will grow."

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